

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

RECEIVED 5 17 4 11

IN RE:

APPLICATION OF MEMPHIS
NETWORKX LLC FOR CCN

)
)
)
)
)

DOCKET NO. 99-00909

PETITION TO INTERVENE

Comes the Office of the Attorney General & Reporter, through its Consumer Advocate Division, pursuant to Tenn. Code Ann. 65-4-118(c)(2)(A), and petitions to intervene in this case. For cause the Petitioner would show as follows:

I.

1. The Consumer Advocate Division of the Office of the Attorney General is authorized by Tenn. Code Ann. § 65-4-118 (c)(2)(A) to initiate a contested case, and participate or intervene in proceedings to represent the interests of Tennessee consumers in accordance with the Uniform Administrative Procedures Act (UAPA).

2. Memphis Networkx is a joint venture with a 50% interest controlled by Memphis Light, Gas & Water. Memphis Networkx has applied to the Tennessee Regulatory Authority for a Certificate of Convenience and Necessity to enter the telecommunications business as a competitive local exchange company. Its counsel and counsel for other interveners are listed on the certificate of service.

3. On May 2, 2000, hearings at the TRA were set to begin after a one day continuance

POSTED
3-8-00

granted in order to allow the parties to attempt to settle the case. Before the hearing began, however, the case took an unexpected turn when Time Warner and Memphis Networkx presented an Amended Application which was, in effect, a settlement agreement between Time Warner and Memphis Networkx that effectively took Time Warner out of the case. After the Amended Application was presented, the TRA postponed the hearing until Tuesday of next week. A copy of the Amended Application is attached as **Exhibit A**.

4. The main issue in this case initially was whether Memphis Networkx has sufficient guidelines in place to prevent "cross-subsidization," whereby the ratepayers of Memphis Light & Gas would be subsidizing the 50% owned Memphis Networkx. The Consumer Advocate Division opposes such cross-subsidization, and has done so in several other cases at the TRA because cross-subsidization adversely affects the interests of consumers and is anticompetitive. Under the Amended Application, Memphis Networkx will not compete in the retail telecommunications business against companies such as Time Warner and BellSouth. Instead Memphis Networkx will act as a wholesaler or "carrier's carrier." Under such a scenario, there is still a problem with cross-subsidization because if Memphis Networkx's wholesale lines are sold to a company such as Time Warner, Time Warner would benefit from the cross-subsidy.

5. Time Warner and other entities with whom Networkx might compete formerly had sufficient interests in assuring that cross-subsidization would be prohibited. With Time Warner effectively out of the case because of the "settlement" reflected in the Amended Application, the Consumer Advocate Division believes that this issue may not be properly presented at the hearing which is set to recommence next week.

6. The Consumer Advocate Division requests the TRA that NARUC guidelines for

prohibiting cross-subsidization by electric companies should be implemented in this case. In addition, FCC guidelines prohibiting cross-subsidization should be implemented when said guidelines provide greater protection for consumers. A copy of the guidelines as proposed by the Consumer Advocate Division is attached as **Exhibit C**.

7. In addition, the Amended Application raises an entirely new concern of anticompetitive activity. It appears that in order to get the parties to stop their opposition to the CCN, Memphis Networkx agreed to limit the scope of its business activities. The Consumer Advocate Division believes that to collude or enter into an agreement for approval by the TRA which limits a company's ability to enter into certain markets and geographic areas, and otherwise limit the scope of its business activities, is anticompetitive and in violation of state law. It further appears that the dominant local exchange company knew or should have known of the agreement and ratified it whether or not its signature appears on the Amended Application. In particular, Paragraphs 1, 3, 4, 5 & 6 of the Amended Application limit the operation, geographic area, time period and customers for which the applicant can compete. The Consumer Advocate Division informed the TRA of its concerns on this issue on May 2, 2000, by letter. A copy of that letter is attached as **Exhibit B**.

8. Section 253 of the Telecommunications Act of 1996 provides that:

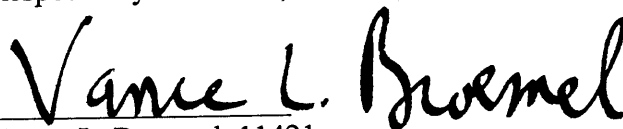
No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.

As written, the Amended Application asks the TRA to approve a requirement limiting competition and the provision of service in violation of federal law.

9. In addition, Tenn. Code Ann. 65-5-208(c) authorizes the TRA to issue an order prohibiting anticompetitive practices and render the agreement among the parties unenforceable.

Wherefore the Petitioner prays the Authority to grant its Petition to Intervene; to implement the NARUC guidelines regarding cross-subsidization for electric utilities and FCC guidelines on cross-subsidization; to hold the agreement among the parties as set forth in the Amended Application anticompetitive and unenforceable; and for such other relief as is just.

Respectfully submitted,

A handwritten signature in black ink that reads "Vance L. Broemel". The signature is written in a cursive style with a large, stylized "V" and "B".

Vance L. Broemel, 11421
Assistant Attorney General
Consumer Advocate Division
Cordell Hull Building, 2nd Floor
425, 5th Avenue North
Nashville, Tennessee 37243-0500
(615)-741-8700

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the Petition to Intervene was served on parties below via U.S. Mail, postage prepaid, this May, 5, 2000.

Guy Hicks, Esquire
BellSouth Telecommunication, Inc.
Suite Room 2101
333 Commerce Street
Nashville, Tennessee 37201

Henry Walker, Esquire
Boult, Cummings, Connors & Berry
411 Union Street
Suite 1600
Nashville, Tennessee 37219

J. Maxwell Williams
Memphis Light Gas & Water
220 South Main Street
Memphis, Tennessee 38103

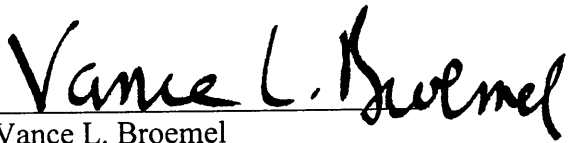
Richard Collier, Esq.
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

R. Dale Grimes, Esq.
Bass, Berry & Sims
2700 First American Center
Nashville, Tennessee 37238

John Knox Walkup
Wyatt, Tarrant & Combs
1500 Nashville City Center
511 Union Street
Nashville, Tennessee 37219

D. Billye Sanders
Waller Lansden Dortch & Davis
511 Union Street
Nashville, Tennessee 37219

Lee J. Bloomfield
One Memphis Place
200 Jefferson Avenue, Suite 1400
Memphis, Tennessee 38103


Vance L. Broemel

AMENDED APPLICATION OF MEMPHIS NETWORKX LLC

Conditions to Certificate of Convenience and Public Necessity (CCN)

The following sets forth conditions to the pending CCN application by Memphis Networkx, L.L.C. (MNet) before the Tennessee Regulatory Authority (TRA) and as agreed to by the undersigned parties.

RECITALS

The parties agree that an open access, wholesale network is proposed by MNet. Further, interveners acknowledge that the applicant is fit, in all material respects, under guidelines established by the TRA, to receive the relief sought under this Amended Application to the TRA. The parties further agree to the following:

SPECIFIC CONDITIONS

1. MNet agrees that it will only provide its services, on a wholesale basis, and at tariff rates (including approved Contract Service Arrangements), as applicable, to unaffiliated third parties.
2. Unaffiliated third parties will be regulated and governed under applicable law.
3. Applicable sections of the Federal Communications Act of 1996, state law and the charter and ordinances of the City of Memphis will define "Affiliated party" and "conflict of interest." Self-dealing and conflict of interest provisions shall apply. MNet or MLGW or their principals shall not own, operate, or receive any benefit, directly or indirectly from any retail provision of services in Tennessee in any geographic areas served by MNet, except as provided in paragraph 6 below. Notwithstanding the foregoing, this provision shall in no way affect revenues or distributions from MNet to its members, or other agreements MLGW may have with telecommunications providers regarding unrelated matters. This provision shall not apply to construction or maintenance services provided to MNet by MLGW or A&L Networks, LLC or affiliates.
4. MNet acknowledges that it must obtain certain applicable franchise agreements while intervenors agree they will support those applications of MNet which are consistent with this Agreement and those required of other similar providers.
5. MNet agrees that, except as provided in paragraph 6 below, it will not seek modification of its CCN for a five (5) year period beginning June 1, 2000, sought herein to expand the scope of its authority as granted by the TRA.
6. Any request to expand the authority granted for the purpose of providing services to retail, end user customers, shall be submitted by petition filed with the TRA and served on the intervenors in this proceeding identifying the "under-served" customers sought to be served together with an explanation of the absence or inadequacy of the service or services available to those customers. The parties agree that factors to be considered in determining whether a customer is "under-served" should include price, quality, choice and availability of meaningful service.
7. Any request for an interdivisional loan from the MLGW Electric Division to its Telecommunications Division in excess of the initially authorized twenty million dollars (\$20,000,000) shall receive approval from the MLGW Board of Commissioners. It is further agreed by MLGW that all intervenors in this matter and the City Council shall receive written notice of any such request and the City Council shall also consider such request.

EX. A

8. MLGW agrees to negotiate/renegotiate the Time Warner pole attachment agreement, which shall include fair and reasonable rates under applicable federal and state law, if any. Such renegotiated agreement shall become effective two (2) years after the effective date of this Agreement. NEXTLINK may also re-negotiate its pole attachment Agreement at any time within two years of the date of this Agreement under similar terms to those of Time Warner. Should Time Warner or NEXTLINK be unable to reach an agreement with MLGW, before seeking legal remedies, the parties will mutually select a mediator with subject matter expertise who shall mediate the dispute. Pending the adoption of a new pole attachment agreement between MLGW and NEXTLINK, NEXTLINK may sublease the right to use facilities attached to MLGW's poles provided that (a) NEXTLINK provide notice of such sublease to MLGW (b) NEXTLINK remains financially and operationally responsible to MLGW for the subleased facilities under existing pole attachment agreements, and (3) unless otherwise agreed by MLGW, NEXTLINK may only sublease the right to use such facilities on a wholesale basis to third parties who will then use the facilities to serve end users.
9. Intervenor agree to join in the petition seeking approval of the CCN under terms set out in this Agreement in TRA proceeding Docket Number 99-00909. Intervenor agree that they will not seek judicial relief or an appeal of the MNet CCN so long as such CCN incorporates the terms of this Agreement. Intervenor will not in any way challenge the authority of the parties to participate in the MNet venture providing they are abiding by all applicable regulatory laws, the CCN incorporating the terms of this Agreement, and applicable TRA rules. If any provision of this Agreement is modified in any material respect, the Agreement shall, at the request of any party hereto, be void as to such party. In such case, the Applicant and joint petitioners, at their option, shall proceed with a hearing on their original application at petitioner's option.
10. All pending litigation in Shelby County Chancery Court Docket Number CH00-0706-3 related to MNet and MLGW concerning public records will not be pursued by Time Warner.
11. The parties agree that they will not seek to legislatively modify municipal authority to participate in telecommunications activities or joint ventures so long as applicant is abiding by applicable law, its CCN incorporating the terms and conditions of this Agreement, and TRA rules.
12. MLGW shall not exercise its condemnation authority for the direct or sole benefit of MNet or its customers, wholesale or otherwise; provided however, this provision shall not apply to MLGW when condemnation is necessary for the purpose of placing, locating or relocating gas, water or electric lines or facilities or when necessary to enable a municipal project. In no event, however, shall MNet receive preferential treatment in obtaining access to such facilities and/or rights of way.

Date: May 1, 2000

For Time Warner Communications of the Mid-South

By: [Signature]

[Signature] - President

For Time Warner Telecom of the Mid-South, LP

By: [Signature]

UP REGUL/SOUTHEAST

For NEXTLINK Tennessee, Inc.

By: Henry Walker ^{by con} with permission

For Tennessee Cable Telecommunications Association

By: [Signature] - Chairman TETA

Memphis Network, LLC

[Signature] CEO

Memphis Light, Gas and Water Division

[Signature], atty

A&L Networks-Tennessee LLC

By: [Signature]

STATE OF TENNESSEE

Office of the Attorney General



PAUL G. SUMMERS
ATTORNEY GENERAL AND REPORTER

ANDY D. BENNETT
CHIEF DEPUTY ATTORNEY GENERAL

LUCY HONEY HAYNES
ASSOCIATE CHIEF DEPUTY
ATTORNEY GENERAL

May 2, 2000

MICHAEL E. MOORE
SOLICITOR GENERAL

CORDELL HULL BUILDING
NASHVILLE, TN 37243-0485

TELEPHONE (615) 741-3491
FACSIMILE (615) 741-2009

David Waddell, Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37238

Re: Application of Memphis Network for Certificate of Convenience
and Necessity, Docket No. 99-00909

Dear Mr. Waddell:

On the morning of Tuesday May 2, 2000, the Consumer Advocate Division received a copy of the Amended Application of Memphis Network LLC filed with the TRA as part of Docket No. 99-00909. The Consumer Advocate Division is not a party to this proceeding but upon reviewing the Amended Application the Consumer Advocate Division has concerns about the Amended Application for a Certificate of Convenience and Necessity (CCN). For the reasons set forth below, the Consumer Advocate Division seeks the publication of the Amended Application so that the public will have received proper notice of the Amended Application and the Consumer Advocate Division will have had sufficient time to review this matter in order to determine whether it should recommend intervention to the Attorney General.

First, the Amended Application raises several new issues that were not present in the original application. The Consumer Advocate made its decision not to intervene based on its understanding of the original application. The main issue appeared to be the implementation of allocation safeguards. It is possible that other members of the public would be interested in reviewing the new matters in the Amended Application and either participate in the hearing or simply notify the TRA of their views. In particular, the Consumer Advocate Division would draw the attention of TRA to Paragraphs 5 & 6 of the Amended Application which may have anti-competitive and anti-trust implications. They limit the geographic area, time period and customers for which the applicant can compete. The dominant carrier was likely consulted and would benefit even if it has not signed.

The Consumer Advocate Division would also point out that Section 253 of the Telecommunications Act of 1996 provides that:

No State or local statute or regulation, or other State or local legal requirement, may

EX.B


prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.

A copy of Section 253 is attached hereto. As written, the Amended Application appears to be asking the TRA to approve a requirement limiting competition and the provision of service.

Furthermore, given the agreement there is a serious question about how effectively the record will be developed on the critical issue of cross-subsidization and the settling interveners are no longer positioning or aligning themselves in a way which also protects the interests of consumers. Accordingly, at the very least, time is needed for the non-settling parties, the TRA staff, and the TRA itself to consider the full implications of the general agreement.

The Consumer Advocate appreciates the fact that this hearing has been scheduled for some time, but respectfully submits that the recent filing of the Amended Application has so changed the nature of this case that a continuance is required.

Sincerely,


Vance L. Broemel

<< 47 USCA § 253 >>

"SEC. 253. REMOVAL OF BARRIERS TO ENTRY.

"(a) IN GENERAL.--No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.

"(b) STATE REGULATORY AUTHORITY.--Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.

Outline of Comments on MLGW and Memphis Network Cost Allocation Manual

1. Standards to evaluate Cost Allocation and Affiliate Transactions
 - A. FCC's Affiliate Transaction Rules (47 CFR § 32.27)
 - B. FCC's Cost Allocation Rules (47 CFR§ 64.901; 64.902; 64.903; & 64.904)
 - C. NARUC Cost Allocation and Affiliate Transactions Guidelines

Type of Transaction	FCC Cost Allocation	FCC Affiliate Transaction	NARUC Cost Allocation and Affiliate Transaction	MLGW Proposal
Tariffed Service	Tariffed Rates	Tariffed Rates	Tariffed Rates	Tariffed Rates
Service provided under Agreement Approved by Commission		Per Agreement	The NARUC Guidelines are flexible enough to allow for special contracts. "Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator." and "Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator."	
Services Provided by Regulated Utility to Affiliate		Higher of Cost or Market Prevailing market may be used if 50% of service provided to third party	Generally Higher of Full Allocated Cost or Prevailing Market Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.	Prevailing Market

Assets Provided by Regulated Utility to Affiliate		<p>Higher of Cost or Net Book Cost</p> <p>Prevailing market may be used if 50% of service Provided to Third Party</p>	<p>Generally Higher of Prevailing Market or Net Book Cost</p> <p>Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.</p>	Prevailing Market
Services Provided by Affiliate to Utility		<p>Lower of Cost or Market</p> <p>Prevailing market may be used if 50% of service Provided to Third Party</p>	<p>Generally Lower of Fully Allocated Cost or Prevailing Market</p> <p>Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.</p>	Prevailing Market
Assets Provided by Affiliate to Utility		<p>Lower of Cost or Market</p> <p>prevailing market may be used if 50% of service Provided to third party</p>	<p>Generally Lower of Prevailing Market or Net Book Cost</p> <p>Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.</p>	Prevailing Market

Non Tariffed Services provided between a regulated utility and its non regulated division	Fully Allocated Cost		<p>Fully Allocated Cost</p> <p>Variation in regulatory environment may justify different cost allocation methods than those embodied in the Guidelines.</p> <p>Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates</p>	Appears to be direct cost
---	----------------------	--	---	---------------------------

2. The NARUC Cost Allocation and Affiliate Transaction Guidelines were adopted to assist Regulatory Commission in dealing with regulated monopoly energy utilities that become involved in non regulated operations through a non regulated division or affiliate.
3. The objective of the Guidelines is to lessen the possibility of improper subsidization and to preserve competition
4. The NARUC Guidelines were developed by a nationally recognized group of accountants and regulators with years of experience in regulation and cost assignment.
5. Unlike the FCC's Guidelines that require the higher of cost or market when a utility provides service to an non regulated affiliates and lower of cost or market when an affiliate provides service to a regulated utility, the NARUC Guidelines provide flexibility. [For example, the FCC's rules provide for the use prevailing market price to record a transaction between a carrier and an affiliate **only** when 50% of the service or product is provided to a third party, when the prevailing market is greater than cost when the regulated utility is providing the service or product, and when the prevailing market price is less than cost when the affility is providing the product or service to the utility.]

The NARUC Guidelines specifically provides:

B. COST ALLOCATION PRINCIPLES

The following allocation principles should be used whenever products or

services are provided between a regulated utility and its **non-regulated affiliate or division.**

1. To the maximum extent practicable, **in consideration of administrative costs**, costs should be collected and classified on a direct basis for each asset, service or product provided.

....

D. AFFILIATE TRANSACTIONS (NOT TARIFFED)

2. Generally, the price for services, products and the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices. **Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.**

The NARUC guidelines provide for a departure from the general rule when the regulator determines that such departure is appropriate.

From Mr. McCullough's testimony it is not clear what the anticipated volume of transactions will be between MLGW and Memphis Network. If there will be few or if the value of the transactions is minor, the use of prevailing market price could possibly be justified on the basis of minimizing the administrative costs. There is insufficient discussion of the volume of transactions between the two entities in the rebuttal testimony to determine whether such a departure is justified. In addition, there should be some trigger for the more formal affiliate transaction rule presented here. If Mr. McCullough is taking an insufficient volume position he should provide supporting proof.

6. Inconsistencies between FCC Affiliate Transaction Rules and MLGW's proposal.

- A. In his testimony Mr. McCullough states:

Although I understand that the FCC's Affiliate Transaction Rules (47 CFR § 32.27) and the structural separation provisions of 47 USC 272(d) are not applicable to MLGW and Memphis Network, I have been advised that Exhibit A is consistent with the spirit of those provisions.

- B. Although he states that MLGW's proposed rules are consistent with the **spirit** of the FCC's Affiliate Transactions Rules 47 CFR §32.27 only the provision that provide for tariffed services to be provided at tariffed rates are consistent.

- i. It isn't clear from the rebuttal testimony how MLGW's proposed rules are consistent with the spirit of the FCC's Affiliate transaction rules while being consistent with the pricing provision for non tariffed products and services.
- Under the MLGW's proposed rules, all transaction between MLGW and Memphis Networkx will be recorded at **prevailing market price**.
 - Under the FCC rules prevailing market is allowed for a transfer of a service from the utility **to an affiliate only** when it is **higher than cost** or when at least **50% of the service or product is provided to a third party**.
 - Mr. McCullough offers no proof that 50% or more of the non tariffed services provided by MLGW to Memphis Networkx are to be provided to a third party, or that prevailing price is greater than costs when MLGW provides service to Memphis Networkx .
- ii. The FCC's rules provide that transfers of non tariffed service or products from an affiliate to a utility at the **lower of cost** or prevailing market, otherwise prevailing market is allowed only when at least 50% of the service is provided to a third party.
- Mr. McCullough proposes to price all transfers at prevailing market.
 - Mr. McCullough offers no proof that 50% or more of the non tariffed services provided by MLGW to Memphis Networkx are to be provided to a third party, or that the prevailing price is less than cost.
- iii. The FCC's rules provide that when a non tariffed asset is provided by utility to an affiliate the price will be the greater of market of net book cost or when at least 50% of such assets are provided to a third parties.

- Mr. McCullough porpoise to price all transfers at prevailing market.
 - Mr. McCullough offers no proof that 50% or more of the non tariffed asset provided by MLGW to Memphis Networkx are to be provided to a third party or that prevailing market is greater than cost.
- iv. The FCC's rules provide that when a non tariffed asset is provided by an affiliate to the utility the price will be the lower of market of net book costs. Prevailing market is allowed only when at least 50% of the service is provided to a third party.
- Mr. McCullough porpoise to price all transfers at prevailing market
 - Mr. McCullough offers no proof that 50% or more of the non tariffed asset provided by MLGW to Memphis Networkx are to be provided to a third party or that prevailing market is less than net book.

Assignment of Cost from MLGW's Electric Division to MLGW's Telecom Division.

7. Although not addressed by Mr. McCullough, in addition to affiliate transaction rules in 47 CFR 32.27, the FCC has adopted Cost Allocation Rules where the utility provides both regulated and non regulated services similar to MLGW's Electric Division and its Telecom Division. [47 CFR § 64.901; 64.902; 64.903; & 64.904] (Generally referred to as Part 64)
- A. Under the FCC Cost Allocation Rules
- Sec. 64.901 Allocation of costs.
- (a) Carriers required to separate their regulated costs from nonregulated costs shall use the attributable cost method of cost allocation for such purpose.
- (b) In assigning or allocating costs to regulated and nonregulated activities, carriers shall follow the principles described herein.

(1) Tariffed services provided to a nonregulated activity will be charged to the nonregulated activity at the tariffed rates and credited to the regulated revenue account for that service.

(2) Costs shall be directly assigned to either regulated or nonregulated activities whenever possible.

(3) Costs which cannot be directly assigned to either regulated or nonregulated activities will be described as common costs. Common costs shall be grouped into homogeneous cost categories designed to facilitate the proper allocation of costs between a carrier's regulated and nonregulated activities. Each cost category shall be allocated between regulated and nonregulated activities in accordance with the following hierarchy:

(i) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves.

(ii) When direct analysis is not possible, common cost categories shall be allocated based upon an indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available.

(iii) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.

B. Mr. McCullough's Exhibit A provides :

"cost allocation between the Electric Division and Telecommunications Division of MLGW shall be governed by the MLGW cost allocation policy summarized in John McCullough's rebuttal testimony"

- The rebuttal testimony does not really address how the cost will be assigned or allocated to the Telecom Division.

- Mr. McCullough does explain that:

"Involvement by MLGW personnel has been in the role of evaluating the potential investment into the LLC and managing the ongoing interest of MLGW as a member."

This leaves several important questions:

- How much effort or time will be devoted to managing MLGW's ongoing interest?
- How many MLGW Telecom Division employees will be engaged in managing MLGW's ongoing interest once Memphis Networkx becomes operational?
- What is the magnitude of the costs that will be incurred by MLGW and assigned or allocated to the Telecom Division once Memphis Networkx becomes operational?

8. Comments on MLGW's allocation manual

A. The FCC's Part 64 Rules provides:

Costs shall be directly assigned to either regulated or nonregulated activities whenever possible.(47 CFR § 64.901(b)(2).

- From the manual it appears that MLGW intends to use the direct assign approach where possible. For example, behind Tab 3 the allocation of Administrative and General Expense it is stated:

At this time, this will not be a vehicle for allocating costs to the Telecom Division **as these cost are identified specifically**. In the future, if costs and number of employees becomes large enough to be too cumbersome to capture costs directly, we can revise the percentage allocation to include the Telecom Division using this method. (Emphasis Added.)

From this appears that cost are currently being directly assigned. The statement, however, raises questions.

- What process is used to identify the Administrative and General Expense directly assigned to the Telecom Division?
- How large is the current costs being identified and assigned to the Telecom Division?
- How large will the cost have to be, in order for the Administrative Expense to be allocated to the Telecom Division using the same procedure used to allocate cost to the other MLGW divisions?

- How many employees will the Telecom Division have to have in order for the Administrative Expense to be allocated to the Telecom Division in the same manner that such costs is allocated to other divisions.
- From this statement can it be anticipated that the number of employees and the cost of the Telecom Division will increase in the future.

B. The FCC rules also require that:

Costs which cannot be directly assigned to either regulated or nonregulated activities will be described as common costs. Common costs shall be grouped into homogeneous cost categories designed to facilitate the proper allocation of costs between a carrier's regulated and nonregulated activities. [47 CFR § 64.901(b)(c)]

C. From the manual it isn't clear that common costs are being allocated to the Telecom Division consistent with the FCC cost allocation procedures. For example behind Tab 2 (Allocation of Common Costs) consist of 2 pages. The first page states:

Costs that are common to two or more Divisions are allocated to the respective Division through the General Ledger System. The system has preset percentages to each Division for several thousand charge codes through which all expenditures must pass; i.e.,

<u>Charge Code</u>	<u>Electric</u>	<u>Gas</u>	<u>Water</u>
Office and Clerical	57%	27%	16%
Labor in the Budget Department			

The percentages are determined by one of several allocation methods based on **number of customers, revenues, or customized formulae**. The allocation methods are updated periodically.

A fourth allocation to Telecom has been added and a percentage assigned for several employee's labor and disbursements. The percentage can, of course, be 100% for a

Division, if appropriate. (Emphasis Added)

The second page appears to be an example showing the 95% of an Administrative Assistant's time is assigned to Charge Code 0119(Office/Clerical Labor-O&M- ADMN) and 5% to Charge Code 5490 (Telecommunications.)

- The description used here is insufficient to determine if the allocation procedures comply with the FCC's cost allocation rules that specifically provide:
 - (i) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves.
 - (ii) When direct analysis is not possible, common cost categories shall be allocated based upon an indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available.
 - (iii) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.
- While the manual offers only a very general description of the allocation percentages used to assign the common costs. There is nothing to support that the factors reflect a direct analysis, an indirect, cost-causative linkages, or using a ration of expenses directly assigned or attributed to regulated and nonregulated activities.
- Nothing is provided to show that the percentage allocates to the Telecom Division is reasonable.
- The manual does not provide directions on how factors are to be developed.
- While stating that a percentage is being allocated to the Telecom Division there is no there isn't enough information in the cost allocation manual to determine if the percentage being allocated is reasonable or even inaccordance with the manual itself.
- For example the manual provides that the **number of customers, revenues, or customized formulae** are factor in allocating costs.
 - Since the Telecom Division will have no customers, how can

customers be considered?

- Since the Telecom Division has no revenue, how can revenues be considered?
 - If a custom formula is used to allocate cost to the Telecom Division, what is that formula?
 - How can the TRA, and independent auditor, or other party determine if the formula and allocation to the Telecom Division is appropriate?
- As addressed later, the FCC's rules require an annual audit to determine if costs are being assigned to the regulated and non regulated operations in accordance with the utility's Cost Allocation Manual (CAM). The wording of MLGW's Cost Allocation Manual is so general it would be difficult to perform such an audit.

Tab 3 (Administrative and General Expense Allocation Factor) also raises some additional concerns with allocation of common costs. From the description of the process, Administrative and General Expense is a group of common costs that are to be allocated to various division. These expenses are grouped into four categories:

Labor Related
Customer Related
Plant Related
Miscellaneous

- With the exception of Miscellaneous Expense the allocation appears to be based on the cost causative concept. The allocation of Miscellaneous Expense using the ratios of the divisions' margins is unrelated to cost and could very likely result in improper allocations. For example the Telecom Division would likely have no revenue and therefore would have an operating loss. Under the allocation procedure under Tab 3, no Miscellaneous Administrative and General Expense would be allocated.

Why shouldn't a portion of Miscellaneous Administrative and General Expense be allocated to the Telecom Division.

9. Reporting and Auditing

Under the FCC Cost Allocation Rules a carrier required to have a Cost Allocation Manual is required each year to have an audit performed by an independent auditor that a positive opinion on whether carrier's annual report present fairly, in all material respects, the information of the carrier required to be set forth therein in accordance with the carrier's cost allocation manual, the Commission's Affiliate Transactions Rules Secs. 32.23 and 32.27 and the Commission Cost Allocation Rules Sec 64.901, and 64.903.

47 CFR Sec. 64.904 Independent audits.

(a) Each local exchange carrier required to file a cost allocation manual, by virtue of having annual operating revenues that equal or exceed the indexed revenue threshold for a given year or by order of the Commission, shall have an audit performed by an independent auditor on an annual basis, with the initial audit performed in the calendar year after the carrier is first required to file a cost allocation manual. The audit shall provide a positive opinion on whether the applicable data shown in the carrier's annual report required by Sec. 43.21(e)(2) of this chapter present fairly, in all material respects, the information of the carrier required to be set forth therein in accordance with the carrier's cost allocation manual, the Commission's Joint Cost orders issued in conjunction with CC Docket No. 86-111 and the Commission's rules and regulations including Secs. 32.23 and 32.27 of this chapter, 64.901, and 64.903 in force as of the date of the auditor's report. The audit shall be conducted in accordance with generally accepted auditing standards, except as otherwise directed by the Chief, Common Carrier Bureau.

Such Audits are to be conducted in accordance with the AICPA's Professional Standards for Attestations.

- The FCC audit requirement has been in place for many years and independent auditor routinely issue such opinion on the carrier's compliance with the cost allocation procedures as set out in the cost allocation manual.
- If MLGW's independent auditor is unable or unwilling to conduct such an audit, this could indicate that there is a problem with MLGW's CAM, or with MLGW's cost allocation procedure.

10. Points that Should be made in the hearing before the TR:

- a. Memphis Networkx will operate independently from MLGW and will have its own employees.
- b. With the exception of the MLGW employees who manage MLGW's investment in Memphis Networkx there will be no joint employees, equipment, or operations with MLGW and Memphis Networkx.
- c. The majority of transactions between Memphis Networkx and MLGW will be recorded at tariffed rates.
- d. Non tariffed services or products will be provided to Memphis Networkx at the same price provided to other independent third parties under contract.
- e. Those transactions not covered by tariff or contracts will be recorded at prevailing price and will be insufficient in number and value to justify the development of a detailed cost allocation procedures prescribed by the FCC in its Affiliate Transactions Rules 47 CFR 32.27.
- f. Any service that is not covered by a tariff or a contract and is provided by MLGW to Memphis Networkx will be made available to any other entity at the same price.
- g. The recording of transactions between MLGW and Memphis Networkx should be governed by the NARUC Cost Allocation and Affiliate Transactions Guidelines that provides that:

Generally, the price for services, products and the use of assets provided by a regulated entity to its non-regulated affiliates should be at the higher of fully allocated costs or prevailing market prices.
Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

Generally, the price for services, products and the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices.
Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

Allocation of Cost to the MLGW Telecom Division

- a. MLGW's Telecom Division is not a operating division as such but is an accounting device used to capture cost incurred by MLGW in managing its

investment in Memphis Networkx.

- b. The Telecom Division will have no employees.
- c. Presently there are ____ MLGW Electric Division employees who devote approximately ____ of their time to managing MLGW's investment in Memphis .
- d. The salary and the related overhead of the employees of the MLGW Electric Division involved in the management of the investment in Memphis Networkx will be recorded in the Telecom Division.
- e. The amount of time these employees devote to the Memphis Networkx operations will be routinely recorded and used as the basis for allocating their salary, their support staffs salaries and other overhead to the Telecom Division.
- f. It is estimated that once Memphis Networkx is operational ____ of these employees time will be devoted to managing MLGW's investment in Memphis Networkx.
- g. It is estimated that once Memphis Networkx is operational approximately \$_____ of MLGW's Electric Division's expense will be assigned to the Telecom Division.

Top of page

<Picture>

Resolution Regarding Cost Allocation Guidelines for the Energy Industry

WHEREAS, There is ongoing concern regarding potential cross-subsidization between the regulated monopoly operations and the non-regulated businesses of electric and gas utilities; and

WHEREAS, Utilities are adopting various business strategies to adjust to the changing retail markets, including forming alliances and creating subsidiaries, divisions and partnerships to participate in non-regulated, competitive markets; and

WHEREAS, State utility commissions are examining and adopting various policies to monitor the competitive activities of regulated energy utilities; and

WHEREAS, State utility commissions are examining and adopting policies and rules concerning potential cross-subsidies between regulated utilities and non-regulated affiliates including pricing of assets, products and services; and

WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC) requested the Staff Subcommittee on Accounts together with the Staff Subcommittees on Strategic Issues and Gas to prepare for NARUC's consideration, "Guidelines for Energy Cost Allocations"; and

WHEREAS, The Staff Subcommittee on Accounts together with the Staff Subcommittees on Gas and Strategic Issues have prepared for NARUC's consideration "Guidelines for Cost Allocations and Affiliate Transactions"; and

WHEREAS, Each State or Federal Regulatory commission may have unique situations and circumstances that govern affiliate transactions, cost allocations, and/or service or product pricing; and

WHEREAS, The "Guidelines for Cost Allocations and Affiliate Transactions" are to provide guidance to the states and are not intended to be rules or regulations prescribing how cost allocations and affiliate transactions are to be handled; and

WHEREAS, The Staff Subcommittees on Accounts, Strategic Issues and Gas should periodically review the Guidelines for Cost Allocations and Affiliate Transactions, taking into consideration the progression of competition in the electric and gas industries nationally, and report their findings, including proposed changes to the guidelines, if necessary, that promote efficiency in

Attachment A

competitive energy markets while guarding against cross-subsidization by monopoly ratepayers; now therefore be it

RESOLVED, The Board of Directors of the of the National Association of Regulatory Utility Commissioners (NARUC), convened in its 1999 Summer Meeting in San Francisco, California, adopts the attached "Guidelines for Cost Allocations and Affiliate Transactions"; and be it further

RESOLVED, The NARUC directs the Staff Subcommittees on Accounts, Strategic Issues and Gas, to review the Guidelines for Cost Allocation and Affiliate Transactions, taking into consideration the progression of competition in the electric and gas industries nationally and report their findings to NARUC, including proposed changes to the guidelines, if necessary, on or before January 1, 2001, and annually thereafter, and be it further

RESOLVED, The NARUC applauds and thanks the Staff Subcommittees on Accounts, Gas, and Strategic Issues for their excellent work in developing the guidelines.

Sponsored by the Committees on Electricity and Finance and Technology

Adopted by the NARUC Board of Directors July 23, 1999

Top of page

<Picture>

Attachment To Resolution Regarding Cost Allocation Guidelines for the Energy Industry
"GUIDELINES FOR COST ALLOCATIONS AND AFFILIATE TRANSACTIONS"

The following Guidelines for Cost Allocations and Affiliate Transactions (Guidelines) are intended to provide guidance to jurisdictional regulatory authorities and regulated utilities and their affiliates in the development of procedures and recording of transactions for services and products between a regulated entity and affiliates. The prevailing premise of these Guidelines is that allocation methods should not result in subsidization of non-regulated services or products by regulated entities unless authorized by the jurisdictional regulatory authority. These Guidelines are not intended to be rules or regulations prescribing how cost allocations and affiliate transactions are to be handled. They are intended to provide a framework for regulated entities and regulatory authorities in the development of their own policies and procedures for cost allocations and affiliated transactions. Variation in regulatory environment may justify different cost allocation methods than those embodied in the Guidelines.

The Guidelines acknowledge and reference the use of several different practices and methods. It is intended that there be latitude in the application of these guidelines, subject to regulatory

oversight. The implementation and compliance with these cost allocations and affiliate transaction guidelines, by regulated utilities under the authority of jurisdictional regulatory commissions, is subject to Federal and state law. Each state or Federal regulatory commission may have unique situations and circumstances that govern affiliate transactions, cost allocations, and/or service or product pricing standards. For example, The Public Utility Holding Company Act of 1935 requires registered holding company systems to price "at cost" the sale of goods and services and the undertaking of construction contracts between affiliate companies.

The Guidelines were developed by the NARUC Staff Subcommittee on Accounts in compliance with the Resolution passed on March 3, 1998 entitled "Resolution Regarding Cost Allocation for the Energy Industry" which directed the Staff Subcommittee on Accounts together with the Staff Subcommittees on Strategic Issues and Gas to prepare for NARUC's consideration, "Guidelines for Energy Cost Allocations." In addition, input was requested from other industry parties. Various levels of input were obtained in the development of the Guidelines from the Edison Electric Institute, American Gas Association, Securities and Exchange Commission, the Federal Energy Regulatory Commission, Rural Utilities Service and the National Rural Electric Cooperatives Association as well as staff of various state public utility commissions.

In some instances, non-structural safeguards as contained in these guidelines may not be sufficient to prevent market power problems in strategic markets such as the generation market. Problems arise when a firm has the ability to raise prices above market for a sustained period and/or impede output of a product or service. Such concerns have led some states to develop codes of conduct to govern relationships between the regulated utility and its non-regulated affiliates. Consideration should be given to any "unique" advantages an incumbent utility would have over competitors in an emerging market such as the retail energy market. A code of conduct should be used in conjunction with guidelines on cost allocations and affiliate transactions.

A. DEFINITIONS

1. Affiliates - companies that are related to each other due to common ownership or control.
2. Attestation Engagement - one in which a certified public accountant who is in the practice of public accounting is contracted to issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party.
3. Cost Allocation Manual (CAM) - an indexed compilation and documentation of a company's cost allocation policies and related procedures.
4. Cost Allocations - the methods or ratios used to apportion costs. A cost allocator can be based on the origin of costs, as in the case of cost drivers; cost-causative linkage of an indirect nature; or one or more overall factors (also known as general allocators).
5. Common Costs - costs associated with services or products that are of joint benefit between

regulated and non-regulated business units.

6. Cost Driver - a measurable event or quantity which influences the level of costs incurred and which can be directly traced to the origin of the costs themselves.

7. Direct Costs - costs which can be specifically identified with a particular service or product.

8. Fully Allocated costs - the sum of the direct costs plus an appropriate share of indirect costs.

9. Incremental pricing - pricing services or products on a basis of only the additional costs added by their operations while one or more pre-existing services or products support the fixed costs.

10. Indirect Costs - costs that cannot be identified with a particular service or product. This includes but not limited to overhead costs, administrative and general, and taxes.

11. Non-regulated - that which is not subject to regulation by regulatory authorities.

12. Prevailing Market Pricing - a generally accepted market value that can be substantiated by clearly comparable transactions, auction or appraisal.

13. Regulated - that which is subject to regulation by regulatory authorities.

14. Subsidization - the recovery of costs from one class of customers or business unit that are attributable to another.

B. COST ALLOCATION PRINCIPLES

The following allocation principles should be used whenever products or services are provided between a regulated utility and its non-regulated affiliate or division.

1. To the maximum extent practicable, in consideration of administrative costs, costs should be collected and classified on a direct basis for each asset, service or product provided.

2. The general method for charging indirect costs should be on a fully allocated cost basis. Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.

3. To the extent possible, all direct and allocated costs between regulated and non-regulated services and products should be traceable on the books of the applicable regulated utility to the applicable Uniform System of Accounts. Documentation should be made available to the appropriate regulatory authority upon request regarding transactions between the regulated utility and its affiliates.

Attachment A

4. The allocation methods should apply to the regulated entity's affiliates in order to prevent subsidization from, and ensure equitable cost sharing among the regulated entity and its affiliates, and vice versa.
5. All costs should be classified to services or products which, by their very nature, are either regulated, non-regulated, or common to both.
6. The primary cost driver of common costs, or a relevant proxy in the absence of a primary cost driver, should be identified and used to allocate the cost between regulated and non-regulated services or products.
7. The indirect costs of each business unit, including the allocated costs of shared services, should be spread to the services or products to which they relate using relevant cost allocators.

C. COST ALLOCATION MANUAL (NOT TARIFFED)

Each entity that provides both regulated and non-regulated services or products should maintain a cost allocation manual (CAM) or its equivalent and notify the jurisdictional regulatory authorities of the CAM's existence. The determination of what, if any, information should be held confidential should be based on the statutes and rules of the regulatory agency that requires the information. Any entity required to provide notification of a CAM(s) should make arrangements as necessary and appropriate to ensure competitively sensitive information derived therefrom be kept confidential by the regulator. At a minimum, the CAM should contain the following:

1. An organization chart of the holding company, depicting all affiliates, and regulated entities.
2. A description of all assets, services and products provided to and from the regulated entity and each of its affiliates.
3. A description of all assets, services and products provided by the regulated entity to non-affiliates.
4. A description of the cost allocators and methods used by the regulated entity and the cost allocators and methods used by its affiliates related to the regulated services and products provided to the regulated entity.

D. AFFILIATE TRANSACTIONS (NOT TARIFFED)

The affiliate transactions pricing guidelines are based on two assumptions. First, affiliate transactions raise the concern of self-dealing where market forces do not necessarily drive prices. Second, utilities have a natural business incentive to shift costs from non-regulated competitive operations to regulated monopoly operations since recovery is more certain with captive ratepayers. Too much flexibility will lead to subsidization. However, if the affiliate transaction

pricing guidelines are too rigid, economic transactions may be discouraged.

The objective of the affiliate transactions' guidelines is to lessen the possibility of subsidization in order to protect monopoly ratepayers and to help establish and preserve competition in the electric generation and the electric and gas supply markets. It provides ample flexibility to accommodate exceptions where the outcome is in the best interest of the utility, its ratepayers and competition. As with any transactions, the burden of proof for any exception from the general rule rests with the proponent of the exception.

1. Generally, the price for services, products and the use of assets provided by a regulated entity to its non-regulated affiliates should be at the higher of fully allocated costs or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.
2. Generally, the price for services, products and the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.
3. Generally, transfer of a capital asset from the utility to its non-regulated affiliate should be at the greater of prevailing market price or net book value, except as otherwise required by law or regulation. Generally, transfer of assets from an affiliate to the utility should be at the lower of prevailing market price or net book value, except as otherwise required by law or regulation. To determine prevailing market value, an appraisal should be required at certain value thresholds as determined by regulators.
4. Entities should maintain all information underlying affiliate transactions with the affiliated utility for a minimum of three years, or as required by law or regulation.

E. AUDIT REQUIREMENTS

1. An audit trail should exist with respect to all transactions between the regulated entity and its affiliates that relate to regulated services and products. The regulator should have complete access to all affiliate records necessary to ensure that cost allocations and affiliate transactions are conducted in accordance with the guidelines. Regulators should have complete access to affiliate records, consistent with state statutes, to ensure that the regulator has access to all relevant information necessary to evaluate whether subsidization exists. The auditors, not the audited utilities, should determine what information is relevant for a particular audit objective. Limitations on access would compromise the audit process and impair audit independence.
2. Each regulated entity's cost allocation documentation should be made available to the company's internal auditors for periodic review of the allocation policy and process and to any jurisdictional regulatory authority when appropriate and upon request.

Attachment A

3. Any jurisdictional regulatory authority may request an independent attestation engagement of the CAM. The cost of any independent attestation engagement associated with the CAM, should be shared between regulated and non-regulated operations consistent with the allocation of similar common costs.
4. Any audit of the CAM should not otherwise limit or restrict the authority of state regulatory authorities to have access to the books and records of and audit the operations of jurisdictional utilities.
5. Any entity required to provide access to its books and records should make arrangements as necessary and appropriate to ensure that competitively sensitive information derived therefrom be kept confidential by the regulator.

F. REPORTING REQUIREMENTS

1. The regulated entity should report annually the dollar amount of non-tariffed transactions associated with the provision of each service or product and the use or sale of each asset for the following:
 - a. Those provided to each non-regulated affiliate.
 - b. Those received from each non-regulated affiliate.
 - c. Those provided to non-affiliated entities.
2. Any additional information needed to assure compliance with these Guidelines, such as cost of service data necessary to evaluate subsidization issues, should be provided.

[Code of Federal Regulations]
[Title 47, Volume 2, Parts 20 to 39]
[Revised as of October 1, 1999]
From the U.S. Government Printing Office via GPO Access
[CITE: 47CFR32.27]

[Page 380-381]

PART 32--UNIFORM SYSTEM OF ACCOUNTS FOR TELECOMMUNICATIONS
COMPANIES--Table of Contents

Subpart B--General Instructions

Sec. 32.27 Transactions with affiliates.

(a) Unless otherwise approved by the Chief, Common Carrier Bureau, transactions with affiliates involving asset transfers into or out of the regulated accounts shall be recorded by the carrier in its regulated accounts as provided in paragraphs (b) through (f) of this section.

(b) Assets sold or transferred between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Non-tariffed assets sold or transferred between a carrier

[[Page 381]]

and its affiliate that qualify for prevailing price valuation, as defined in paragraph (d) of this section, shall be recorded at the prevailing price. For all other assets sold by or transferred from a carrier to its affiliate, the assets shall be recorded at the higher of fair market value and net book cost. For all other assets purchased by or transferred to a carrier from its affiliate, the assets shall be recorded at the lower of fair market value and net book cost. For purposes of this section carriers are required to make a good faith determination of fair market value.

(c) Services provided between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Non-tariffed services provided between a carrier and its affiliate pursuant to publicly-filed agreements submitted to a state commission pursuant to

section 252(e) of the Communications Act of 1934 or statements of generally available terms pursuant to section 252(f) shall be recorded using the charges appearing in such publicly-filed agreements or statements. Non-tariffed services provided between a carrier and its affiliate that qualify for prevailing price valuation, as defined in paragraph (d) of this section, shall be recorded at the prevailing price. For all other services provided by a carrier to its affiliate, the services shall be recorded at the higher of fair market value and fully distributed cost. For all other services received by a carrier from its affiliate, the service shall be recorded at the lower of fair market value and fully distributed cost, except that services received by a carrier from its affiliate that exist solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost. For purposes of this section carriers are required to make a good faith determination of fair market value.

(d) In order to qualify for prevailing price valuation in paragraphs (b) and (c) of this section, sales of a particular asset or service to third parties must encompass greater than 50 percent of the total quantity of such product or service sold by an entity. Carriers shall apply this 50 percent threshold on a asset-by-asset and service-by-service basis, rather than on a product line or service line basis. In the case of transactions for assets and services subject to section 272, a BOC may record such transactions at prevailing price regardless of whether the 50 percent threshold has been satisfied.

(e) Income taxes shall be allocated among the regulated activities of the carrier, its nonregulated divisions, and members of an affiliated group. Under circumstances in which income taxes are determined on a consolidated basis by the carrier and other members of the affiliated group, the income tax expense to be recorded by the carrier shall be the same as would result if determined for the carrier separately for all time periods, except that the tax effect of carry-back and carry-forward operating losses, investment tax credits, or other tax credits generated by operations of the carrier shall be recorded by the carrier during the period in which applied in settlement of the taxes otherwise attributable to any member, or combination of members, of the affiliated group.

(f) Companies that employ average schedules in lieu of actual costs are exempt from the provisions of this section. For other organizations, the principles set forth in this section shall apply equally to corporations, proprietorships, partnerships and other forms of business organizations.

Attachment B

FR 2925, Jan. 21, 1997]

[Code of Federal Regulations]
[Title 47, Volume 3, Parts 40 to 69]
[Revised as of October 1, 1999]
From the U.S. Government Printing Office via GPO Access
[CITE: 47CFR64.901]

[Page 209-210]

TELECOMMUNICATION

CHAPTER I--FEDERAL COMMUNICATIONS COMMISSION--(CONTINUED)

PART 64--MISCELLANEOUS RULES RELATING TO COMMON CARRIERS--Table of Contents

Subpart I--Allocation of Costs

Sec. 64.901 Allocation of costs.

(a) Carriers required to separate their regulated costs from nonregulated costs shall use the attributable cost method of cost allocation for such purpose.

(b) In assigning or allocating costs to regulated and nonregulated activities, carriers shall follow the principles described herein.

(1) Tariffed services provided to a nonregulated activity will be charged to the nonregulated activity at the tariffed rates and credited to the regulated revenue account for that service.

(2) Costs shall be directly assigned to either regulated or nonregulated activities whenever possible.

(3) Costs which cannot be directly assigned to either regulated or nonregulated activities will be described as common costs. Common costs shall be grouped into homogeneous cost categories designed to facilitate the proper allocation of costs between a carrier's regulated and nonregulated activities. Each cost category shall be allocated between regulated and nonregulated activities in accordance with the following hierarchy:

(i) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves.

(ii) When direct analysis is not possible, common cost categories

shall be allocated based upon an indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available.

(iii) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and nonregulated activities.

(4) The allocation of central office equipment and outside plant investment costs between regulated and nonregulated activities shall be based upon the relative regulated and nonregulated usage of the investment during the calendar year when nonregulated usage is greatest in comparison to regulated usage during the three calendar years beginning with the calendar year during which the investment usage forecast is filed.

[[Page 210]]

(c) A telecommunications carrier may not use services that are not competitive to subsidize services subject to competition. Services included in the definition of universal service shall bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

[52 FR 6560, Mar. 4, 1987, as amended at 52 FR 39534, Oct. 22, 1987; 54 FR 49762, Dec. 1, 1989; 62 FR 45588, Aug. 28, 1997]

[Code of Federal Regulations]

[Title 47, Volume 3, Parts 40 to 69]

[Revised as of October 1, 1999]

From the U.S. Government Printing Office via GPO Access

[CITE: 47CFR64.902]

[Page 210]

TELECOMMUNICATION

CHAPTER I--FEDERAL COMMUNICATIONS COMMISSION--(CONTINUED)

PART 64--MISCELLANEOUS RULES RELATING TO COMMON CARRIERS--Table of Contents

Subpart I--Allocation of Costs

Sec. 64.902 Transactions with affiliates.

Except for carriers which employ average schedules in lieu of determining their costs, all carriers subject to Sec. 64.901 are also subject to the provisions of Sec. 32.27 of this chapter concerning transactions with affiliates.

[55 FR 30461, July 26, 1990]

[Code of Federal Regulations]

[Title 47, Volume 3, Parts 40 to 69]

[Revised as of October 1, 1999]

From the U.S. Government Printing Office via GPO Access

[CITE: 47CFR64.903]

[Page 210]

TELECOMMUNICATION

CHAPTER I--FEDERAL COMMUNICATIONS COMMISSION--(CONTINUED)

PART 64--MISCELLANEOUS RULES RELATING TO COMMON CARRIERS--Table of Contents

Subpart I--Allocation of Costs

Sec. 64.903 Cost allocation manuals.

(a) Each local exchange carrier with annual operating revenues that equal or exceed the indexed revenue threshold, as defined in Sec. 32.900 of this chapter, shall file with the Commission within 90 days after publication of that threshold in the Federal Register, a manual containing the following information regarding its allocation of costs between regulated and unregulated activities:

- (1) A description of each of the carrier's nonregulated activities;
- (2) A list of all the activities to which the carrier now accords incidental accounting treatment and the justification therefor;
- (3) A chart showing all of the carrier's corporate affiliates;
- (4) A statement identifying each affiliate that engages in or will engage in transactions with the carrier and describing the nature, terms and frequency of each transaction;
- (5) A cost apportionment table showing, for each account containing costs incurred in providing regulated services, the cost pools with that account, the procedures used to place costs into each cost pool, and the method used to apportion the costs within each cost pool between regulated and nonregulated activities; and
- (6) A description of the time reporting procedures that the carrier uses, including the methods or studies designed to measure and allocate non-productive time.

(b) Each carrier shall ensure that the information contained in its cost allocation manual is accurate. Carriers must update their cost allocation manuals at least annually, except that changes to the cost apportionment table and to the description of time reporting procedures must be filed at least 15 days before the carrier plans to implement the changes. Annual cost allocation manual updates shall be filed on or before the last working day of each calendar year. Proposed changes in the description of time reporting procedures, the statement concerning affiliate transactions, and the cost apportionment table must be accompanied by a statement quantifying the impact of each change on regulated operations. Changes in the description of time reporting procedures and the statement concerning affiliate transactions must be quantified in \$100,000 increments at the account level. Changes in cost apportionment tables must be quantified in \$100,000 increments at the cost pool level. The Chief, Common Carrier Bureau may suspend any such charges for a period not to exceed 180 days, and may thereafter allow the change to become effective or prescribe a different procedure.

(c) The Commission may by order require any other communications common carrier to file and maintain a cost allocation manual as provided in this section.

Sec. 43.21(e)(2) of this chapter present fairly, in all material respects, the information of the carrier required to be set forth therein in accordance with the carrier's cost allocation manual, the Commission's Joint Cost Orders issued in conjunction with CC Docket No. 86-111 and the Commission's Accounting Safeguards proceeding in CC Docket No. 96-150 and the Commission's rules and regulations including Secs. 32.23 and 32.27 of this chapter and Secs. 64.901 and 64.903 in force as of the date of the auditor's report. The audit shall be conducted in accordance with generally accepted auditing standards, except as otherwise directed by the Chief, Common Carrier Bureau.

(b) A mid-sized incumbent local exchange carrier, as defined in Sec. 32.9000, required to file a cost allocation manual, shall have an attest engagement performed by an independent auditor every two years covering the two year period, with the initial engagement performed in the calendar year after the carrier is first required to file a cost allocation manual. The attest engagement shall be an examination engagement and shall provide a written communication that expresses an opinion that the results reported pursuant to Sec. 43.21(e)(2) of this chapter are an accurate application of the Commission's Joint Cost orders issued in conjunction with CC Docket No. 86-111 and the Commission's Accounting Safeguards proceeding in CC Docket No. 96-150 and the Commission's rules and regulations including Secs. 32.23 and 32.27 of this chapter and Secs. 64.901 and 64.903 in force as of the date of the auditor's written report. The written communication shall also express an opinion that the cost methodologies in place are in conformance with the cost allocation manual filed with the Commission. The attest engagement shall be conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants, except as otherwise directed by the Chief, Common Carrier Bureau.

(c) The report of the independent auditor shall be filed at the time that the local exchange carrier files the annual report required by Sec. 43.21(f)(2) of this chapter.

[57 FR 4375, Feb. 5, 1992, as amended at 62 FR 39779, July 24, 1997; 64 FR 50009, Sept. 15, 1999]

Effective Date Note: At 64 FR 50009, Sept. 15, 1999, Sec. 64.904 was amended by revising paragraph (a), redesignating paragraph (b) as paragraph (c), and adding a new paragraph (b), effective Nov. 15, 1999. For the convenience of the user, the superseded text is set forth as follows:

Sec. 64.904 Independent audits.

(a) Each local exchange carrier required to file a cost allocation manual, by virtue of having annual operating revenues that equal or exceed the indexed revenue threshold for a given year or by order of the Commission, shall have an audit performed by an independent auditor on an annual basis, with the initial audit performed in the calendar year after the carrier is first required to file a cost allocation manual. The audit shall provide a positive opinion on whether the applicable data shown in the carrier's annual report required by Sec. 43.21(e)(2) of this chapter present fairly, in all material respects, the information of the carrier required to be set forth therein in accordance with the carrier's cost allocation manual, the Commission's Joint Cost orders issued in conjunction with CC Docket No. 86-111 and the Commission's rules and regulations including Secs. 32.23 and 32.27 of this chapter, 64.901, and 64.903 in force as of the date of the auditor's report. The audit shall be conducted in accordance with generally accepted auditing standards, except as otherwise directed by the Chief, Common Carrier Bureau.

* * * * *

Federal Communications Commission

Washington, D.C. 20554

In reply refer to:
RAO Letter 12

Released: April 11, 1988

Responsible Accounting Officers

Re: Attestation Audits pursuant to the Joint Cost Order and Joint Cost
Reconsideration Order (CC Docket 86-111)

In prescribing rules for the separation of costs of regulated telephone services from costs of nonregulated activities, the Federal Communications Commission concluded that independent audits would be an important aid in implementing its commitment to monitor compliance with cost allocation requirements. The Commission further concluded that an appropriate level of assurance would be an examination leading to a positive opinion. Accordingly, the Commission required that each operating company have an independent audit performed annually and that a positive opinion audit report be submitted each year attesting to the accuracy of the carriers' cost allocations as reported to the Commission. In the process of complying with these requirements, questions have been raised regarding the Commission reports to which the auditors' attestation reports will apply, how and when they should be filed, and what the attestation covers. In this RAO letter we are responding to these questions.

The auditors' reports should accompany the Report of Annual Revenue Requirement and Joint Cost Data, identified as Appendix C of the ARMIS Order (CC Docket 86-182, 2 FCC Rcd 5770 (1987)), aggregated to the operating company level; and attest to the accuracy of cost allocations reported therein, including the effects of transactions with affiliates. Both the auditors' reports and the Report of Annual Revenue Requirement and Joint Cost Data are to be filed April 1 of each year.

In order to facilitate the submission of the attestations by the independent auditors, we have prepared a sample attestation letter designed to provide the assurances the FCC is seeking. The sample letter is intended as a guide and will encompass the requirements of the Joint Cost Order and the Joint Cost Reconsideration Order. The attestation letters will undoubtedly vary according to the circumstances and independent auditors should not view themselves as bound by the literal format of the sample letter.

However, at a minimum, the letter should:

1. Identify the operating company entity;

Federal Communications Commission

DA 88-497

2. Stipulate that the report is prepared for the Federal Communications Commission;
3. Identify the period covered by the report;
4. Stipulate that the report was prepared pursuant to Federal Communications Commission rules for the assignment and allocation of costs between regulated and nonregulated activities and for accounting for transactions with affiliates, including the valuation of assets and services in those transactions;
5. State that the examination was made in accordance with standards established by the American Institute of Certified Public Accountants and included such tests of the ~~underlying~~ records and such other procedures as were considered necessary under the circumstances;
6. Identify the scope and the extent of examination, including any limitations imposed on the scope of the work or extent of the examination by the carrier, its affiliates, or any other circumstances (References should be made here to attached work plans);
7. Provide an opinion of whether or not the methodologies in place are in conformity with the cost allocation manual approved by the Federal Communications Commission, are consistent with the Commission's rules for the assignment and allocation of costs between regulated and nonregulated activities, and are consistent with the accounting for transactions with affiliates, including the valuation of assets and services in those transactions. The opinion should also state whether or not the reported results are an accurate application of those methodologies.

This **Responsible Accounting Officer** letter is issued under Section 0.291 of the Commission's rules. Applications for review under Section 1.115 of the Commission's rules must be filed within 30 days from the date indicated above (See Section 1.4(b)(4) of the Commission's rules).

Sincerely,

Kenneth P. Moran
Chief, Accounting and Audits Division

Attachment

To: Secretary
Federal Communications Commission

We have examined the accompanying Report of Annual Revenue Requirement and Joint Cost Data for (Carrier Name), which was prepared for the Federal Communications Commission. The accompanying Report for the period ended (Date), was prepared pursuant to Federal Communications Commission rules for assignment and allocation of costs between regulated and nonregulated activities and for accounting for transactions with affiliates (47 CFR Sections 32.14, 32.23, and 32.27; and Section 64.901). Our examination was made in accordance with standards established by the American Institute of Certified Public Accountants and included such tests of the underlying records and such other procedures as we considered necessary under the circumstances. [Exceptions, if any]. These tests and procedures included ... [statement of scope and the extent of examination and any limitations on either the scope or the extent of the examination] [Reference should be made to attached work plans].

In our opinion, the methodologies in place are in conformity with the cost allocation manual approved by the Federal Communications Commission [Exceptions] and are consistent with the Commission's rules for the assignment and allocation of costs between regulated and nonregulated activities and for accounting for transactions with affiliates, including the valuation of assets and services in those transactions. The results contained in the accompanying report showing the separation of costs between regulated and nonregulated activities of (Carrier Name) are an accurate application of those methodologies.

**FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

IN REPLY REFER TO: 1600E

RAO Letter 26
DA 98-855
Adopted: May 6, 1998
Released: May 6, 1998

Responsible Accounting Officer

Re: Cost Allocation Manuals - Section V. Transactions With Affiliates

This letter revises the guidelines carriers must follow in preparing the affiliate transactions section of their cost allocation manuals (CAMs). Through this letter, we accomplish three objectives. First, we address discrepancies in the CAM filing format that Commission staff uncovered during our recent review of the CAMs. Second, we revise the CAM filing format to ensure that carriers understand and comply with the changes to the Commission's affiliate transactions rules adopted in the *Accounting Safeguards Order*.¹ Finally, we streamline the CAM filing format by eliminating approximately 40% of the required pages in order to reduce the reporting burden on carriers.

In the *Accounting Safeguards Order*, the Commission amended the Part 32 affiliate transactions rules.² In particular, four of these amendments may require carriers to change their CAMs. These amendments include: (1) establishing uniform valuation methodologies for the provision of services and the transfer of assets between regulated and nonregulated affiliates;³ (2) establishing an exception to the valuation rules for nonregulated service affiliates providing services to a regulated affiliate;⁴ (3) allowing prices appearing in certain publicly-filed agreements in the

¹ Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, *Report and Order*, 11 FCC Rcd 17539 (1996) ("*Accounting Safeguards Order*").

² See 47 C.F.R. § 32.27.

³ See Appendix A.

⁴ *Id.*

place of tariffed rates when tariffed rates are not available;⁵ and (4) applying the authorized rate of return on interstate services, currently 11.25%, when determining fully distributed cost.⁶

We address the necessary changes to the CAM filing format in the appendices to this letter. Appendix A provides the list of terms as set forth in Section 32.27 of the Commission's rules that carriers should use in their CAMs when describing transactions between regulated and nonregulated affiliates. Appendix B presents the format for the affiliate transactions section of the CAM and details the information that carriers must provide in this section.⁷ Finally, Appendix C contains an example of the revised affiliate transactions matrix format.

The guidance in this RAO letter supersedes the CAM uniformity requirements for affiliate transactions set forth in Section A.4 of the Appendix to *RAO Letter 19*,⁸ released December 23, 1991, but it does not supersede any other aspect of *RAO Letter 19*. Carriers that are required to file CAMs must use the format established in this RAO letter no later than December 31, 1998, although such carriers are permitted to revise their CAMs accordingly before that date.⁹

This letter is issued pursuant to authority delegated under Section 0.291 of the Commission's Rules, 47 C.F.R. § 0.291. Applications for review under Section 1.115 of the Commission's Rules, 47 C.F.R. § 1.115, must be filed within 30 days of the date of this letter. See 47 C.F.R. § 1.4(b)(2).

If you have any questions, please contact José-Luis Rodríguez at (202) 418-0810.

FEDERAL COMMUNICATIONS COMMISSION

Kenneth P. Moran, Chief
Accounting Safeguards Division

⁵ *Id.*

⁶ *See* Appendices A and B.

⁷ Carriers provide information about their affiliate transactions in Section V of their CAMs.

⁸ *See* Responsible Accounting Officer Letter No. 19, 6 FCC Rcd 7536 (1991) ("*RAO Letter 19*"). In *RAO Letter 19*, the Accounting and Audits Division established a uniform filing format for the CAMs and a standard procedure for filing CAM revisions.

⁹ Because the modifications to the affiliate transactions rules were effective on August 12, 1997, carriers must reflect these modifications in their CAMs after that date. The deadline for the format specified in this RAO letter should not be construed to represent a modification to the effective date of the *Accounting Safeguards Order*.

The affiliate transactions rules specify the valuation methodologies that carriers must use in accounting for transactions between regulated and nonregulated affiliates. In the course of our cost allocation manual (CAM) review experience, we have noted that the descriptions that many carriers use in their CAMs lack the necessary detail to determine whether the carrier fully understands and complies with the Commission's accounting rules. For example, carriers have used the word "cost" to describe the method used to value certain affiliate transactions. The word "cost," by itself, lacks precision and may be interpreted in a number of ways. In order to prevent confusion arising from multiple definitions of similar terms, and also to ensure uniformity for CAM reporting purposes, we require carriers to use the definitions listed in Section A below when describing affiliate transactions. In Sections B and C below, we describe terms used in valuing asset and service transactions.

A. General Definitions:

- (1) "tariffed rates" -- rates provided pursuant to documents filed with state or federal regulatory authorities.
- (2) "publicly-filed agreements/statements of generally available terms" -- charges appearing in publicly-filed agreements submitted to a State commission pursuant to section 252(e) or statements of generally available terms pursuant to section 252(f) in place of tariffed rates when tariffed rates are not available.¹⁰
- (3) "prevailing price" -- the price at which a company offers an asset or service to the general public. In order to qualify for prevailing price valuation, sales of a particular asset or service to third parties must encompass greater than 50 percent of the total quantity of such product or service sold by an entity. Carriers shall apply this 50 percent threshold on an asset-by-asset and service-by-service basis, rather than on a product line or service line basis.¹¹
- (4) "fair market value" -- the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.¹²
- (5) "net book cost" -- the original cost of an asset adjusted by the associated valuation reserves (e.g., accumulated depreciation, deferred taxes, etc.).

¹⁰ See *Accounting Safeguards Order*, 11 FCC Rcd at 17612-13 para. 158.

¹¹ *Id.* at 17600-601 paras. 135-136.

¹² See *Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, *Notice of Proposed Rulemaking*, 11 FCC Rcd 9054, fn. 167.

- (6) "fully distributed cost" -- cost determined in a manner that complies with the standards and procedures for the apportionment of special, joint, and common costs between the regulated and nonregulated operations of the carrier.¹³ A fully distributed costing methodology apportions the total costs of a group of services or products--including the authorized interstate rate of return--among the individual services or products in that group. In general, this process directly assigns some of the costs to individual services or products. The remaining costs are allocated among individual services or products based on relative use measurements or estimates of relative use. The resulting cost apportionments determine the share of total cost that is attributed to each service or product.¹⁴

B. Valuation Methods for the Sale or Transfer of Assets:

- (1) "tariffed rate" -- is to be used when assets are sold or transferred between a carrier and its affiliates pursuant to existing tariffs, including a tariff filed with a state commission.
- (2) "prevailing price" -- is to be used when non-tariffed assets are sold or transferred between a carrier and its affiliates that qualify for prevailing price. To qualify for prevailing price, the sale of a particular asset must encompass greater than 50% of the total quantity of such product sold by an entity. Carriers shall apply this 50 percent threshold on an asset-by-asset basis rather than on a product-line basis. In the case of transactions for assets subject to 47 U.S.C. § 272, a Bell operating company may record such transactions at prevailing price regardless of whether the 50 percent threshold has been satisfied.
- (3) "higher of fair market value and net book cost" -- is to be used for all other assets sold by or transferred from the carrier to its affiliates. For each asset listed under this classification, the carrier must include the specific valuation method in effect at the date of the CAM filing by inserting either FMV (fair market value) or NBC (net book cost) next to each asset listed.
- (4) "lower of fair market value and net book cost" -- is to be used for all other assets purchased by or transferred to the carrier from its affiliates. For each asset listed under this classification, the carrier must include the specific valuation method in effect at the date of the CAM filing by inserting either FMV or NBC next to each asset listed.

¹³ 47 C.F.R. § 64.901(b).

¹⁴ See *Accounting Safeguards Order*, fn. 139.

C. Valuation Methods for the Provision of Services:

- (1) "tariffed rate" -- is to be used when services are sold or transferred between a carrier and its affiliates pursuant to existing tariffs, including a tariff filed with a state commission.
- (2) "rate pursuant to a publicly-filed agreement" rate -- is to be used when non-tariffed services are sold or transferred between a carrier and its affiliates pursuant to publicly filed agreements submitted to state commissions pursuant to section 252(e) of the Communications Act of 1934, as amended, (the Act) or statements of generally available terms pursuant to section 252(f).
- (3) "prevailing price" -- is to be used when non-tariffed services are sold or transferred between a carrier and its affiliates that qualify for prevailing price. To qualify for prevailing price, the sale of a particular service must encompass greater than 50% of the total quantity of such service sold by an entity. Carriers shall apply this 50 percent threshold on a service-by-service basis rather than on a service-line basis. In the case of transactions for services subject to 47 U.S.C. § 272, a Bell operating company may record such transactions at prevailing price regardless of whether the 50 percent threshold has been satisfied.
- (4) "higher of fair market value and fully distributed cost" -- is to be used for all other services sold by or transferred from the carrier to its affiliates. For each service listed under this classification, the carrier must include the specific valuation method in effect at the date of the CAM filing by inserting either FMV or fully distributed cost (FDC) next to each service listed.
- (5) "lower of fair market value and fully distributed cost" -- is to be used for all other services purchased by or transferred to the carrier from its affiliates (except that services received by a carrier from its affiliates that exist *solely* to provide services to members of the corporate family shall be recorded at FDC, as shown below in item (6)). For each service listed under this classification, the carrier must include the specific valuation method in effect at the date of the CAM filing by inserting either FMV or FDC next to each service listed.
- (6) "fully distributed cost" -- is to be used only when a carrier purchases services from an affiliate that exists *solely* to provide services to members of the carrier's corporate family. In order to qualify for this classification, the services affiliate must not have *any* sales with outside parties.

Section V of the CAM should be organized in the following manner and include the following topics:

- A. Introduction -- In this section, carriers should include a description of our affiliate transactions rules and how they apply them. Inclusion of this information provides assurance that the carrier is aware of, and is appropriately applying, the affiliate transactions rules. When describing the "terms" of the affiliate transactions, carriers must use the definition of terms as specified in Appendix A. In this section, carriers must also include a statement that fully distributed cost includes a return component calculated using the authorized interstate rate of return.¹⁵ This statement must specify the interstate rate of return in use. (Note: the current prescribed interstate rate of return is 11.25 percent).¹⁶
- B. List of Affiliates -- This section must include the following information:
- (1) A listing of affiliates with which the carrier engages in, or will engage in, affiliate transactions. For each affiliate listed, provide a brief narrative describing the nature of its business.
 - (2) When listing the affiliates, any separate affiliate(s) established to meet the requirements of Section 272 of the Act, must be so identified (i.e., XYZ Long Distance Co., (Section 272 affiliate)).
 - (3) When listing the affiliates, any affiliate that exists *solely* to provide services to members of the carrier's corporate family must be so identified (i.e., ABC Company. For transactions with this affiliate, the FDC exception applies).
- C. List of Assets and Services Provided -- As discussed in Appendix C, we streamline the matrix for reporting transactions between the carrier and its affiliates. As shown in that matrix, we allow carriers to list assets and services by category. In this section, carriers must list and describe each of those asset and service categories, as presented on that matrix. The description can be a narrative explaining these assets or services, or it can contain a list of activities that are provided under each service. To conform to the matrix format, this list must be separated into two sections: assets and services provided by the carrier to its affiliates; and assets and services received by the carrier from its affiliates. For CAM presentation purposes, a carrier may combine various types of assets or services into homogeneous groups. These groups must separate regulated activities from nonregulated activities. For assets or services that, under different circumstances, are provided at a

¹⁵ See Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket No. 89-624, *Order*, 5 FCC Rcd 7507, 7509 para. 13 (1990).

¹⁶ See *Accounting Safeguards Order*, 11 FCC Rcd at 17616-17 paras. 165-6.

combination of more than one of the following: prevailing price, fair market value, and/or fully distributed cost, an explanation must be provided in the description to explain these circumstances. Below, we provide several examples of asset or service categories that may appear on the matrix and describe how they should be presented in this section.

(1) Examples of Assets or Services Provided by the Telephone Company to its Affiliates:

- (a) Marketing Services -- includes market research, strategic planning, market surveys, consulting services.
- (b) Real Estate Services -- includes lease arrangements and tenant improvement management. Leasing arrangements can be offered in some office buildings at prevailing price, and in other office buildings at the higher of fully distributed cost or fair market value. (Provide an explanation of why this occurs.)
- (c) Public Relations -- (1) support: includes communication consultation, writing services, production management for media, and presentation design and development and (2) television services: includes scripting production, editing, duplication, and live broadcasting.
- (d) Telecommunications Services -- includes basic exchange and intraLATA toll services.
- (e) Voice Messaging -- allows subscribers to leave, direct, and retrieve voice messages.

(2) Examples of Assets or Services Received by the Telephone Company from its Affiliates:

- (a) Marketing Services -- marketing of telecommunications services and products.
- (b) Directory Advertising -- advertising in both white and yellow pages.
- (c) Legal Services -- includes legal representation in areas of commercial litigation, labor law, and corporate transactions.

D. Matrix -- This section must contain a matrix showing each type of asset or service involved in the affiliate transaction, and the terms and the frequency of each type of transaction. The matrix must be grouped into two categories: transactions from the carrier to its affiliates and transactions from the affiliates to the carrier. In the matrix, carriers must identify the affiliate

transactions they engage in, or will engage in, by using

a code denoting the frequency with which they engage in, or will engage in, those transactions. The following codes must be used when describing the frequency of the transactions:

D	=	Daily
W	=	Weekly
M	=	Monthly
Q	=	Quarterly
A	=	Annually
O	=	Occasionally

The matrix must include a legend of the codes used. In the event that these codes do not fit a particular circumstance, contact the Accounting Safeguards Division for prior approval before adding a code. If approval is authorized, the new code must be included in the legend. See Appendix C for an example of the matrix.

The matrix must be designed as shown in this Appendix. As noted in Appendix B, the matrix must contain each type of asset or service, the affiliate involved, and the terms and the frequency of each type of transaction. The matrix must be grouped into two categories: transactions from the carrier to its affiliates and transactions from the affiliates to the carrier. In preparing the matrix, please keep the following in mind:

- A. The matrix must be organized using the "terms" of affiliate transactions as major headings in column 1. Carriers must use the "terms" as defined in Appendix A. Each type of affiliate transaction (assets and services provided or received) is then entered into the matrix according to the terms with which it is provided or received.
- B. When listing assets or services under the category "Higher of Fair Market Value and Net Book Cost", "Higher of Fair Market Value and Fully Distributed Cost", "Lower of Fair Market Value and Net Book Cost", and "Lower of Fair Market Value and Fully Distributed Cost", designate the specific valuation method used to value the transaction by inserting either FMV (fair market value), NBC (net book cost), or FDC (fully distributed cost), in parenthesis, next to each service listed. The valuation method identified must be the method in effect at the date of the CAM filing.
- C. Services listed under the category "Fully Distributed Cost" must include only those services received by a carrier from its affiliates that exist *solely* to provide services to members of the carrier's corporate family. Other services offered or provided at FDC which must meet the "higher or lower" test, as discussed above, are included in that section of the matrix, and so identified.